



Prediction markets open insider training minefield for corporate counsel: What to know

By: Kallie Cox In Featured, Top News

- Summary
• Prediction markets have rapidly grown into a billion-dollar industry, creating new insider trading and compliance concerns for businesses.
• Attorneys warn that material non-public information (MNPI) now extends beyond stock-related data to include product launches, marketing plans, and operational events.
• Regulatory uncertainty persists as the CFTC, states, and federal courts debate oversight of prediction market contracts.
• Corporate counsel are encouraged to update policies, employee handbooks, and training programs to address prediction market risks.

The popularity of prediction markets has skyrocketed in recent years following the legalization of sports betting. Now, more industries than ever must consider insider trading risks as their employees engage in these markets.

Missouri Lawyers Media spoke with attorneys — including those formerly with the Commodity Futures Trading Commission and Securities and Exchange Commission — who are watching this emerging field about best practices for corporate counselors.

These attorneys say that the definition of what might be considered material non-public information must be expanded and that the lines between what is insider trading and what isn't are blurring amid the lack of regulation for these markets.

The endless market

David Chase, an SEC defense lawyer and former senior counsel for the SEC's Miami Regional Office, said that following the wave of the legalization of sports betting, prediction markets have "exploded."

"It's not unlike speculating in the stock market, particularly in low-priced securities like penny stocks," Chase said. "This seems to be another adrenaline-fueled type of speculative activity where people can put money on the line, and make educated guesses or speculative guesses, and make money or lose money. So, it just seems to be another iteration of that which we have seen in the sports markets, stock exchange, to some extent crypto and now the prediction markets."

Brett Shanks, of counsel with Stinson in Kansas City, said that although prediction markets are still emerging and are relatively new, they have already become a billion-dollar industry.

"From both the business standpoint and then the legal standpoint, because it's a very uncertain legal landscape in a lot of ways (...) it's so interesting, because it went from nothing to virtually overnight having like Super Bowl commercials about prediction markets," Shanks said.

Because one can bet on virtually anything on a prediction market platform from the weather, to politics, to celebrity outfits, the traditional view most people have of insider trading is no longer accurate, Shanks said.

Most people would have previously pictured insider trading as something done by a stereotypical high level executive using material non-public information to buy or sell stock for their own benefit based off secret earnings information that hasn't been released or stock price news, Shanks said. Now, anyone within a company could intentionally or unintentionally violate insider trading laws.

"You're basically buying a contract that something will happen, or something won't happen, or when something will happen and that something could be virtually anything. So, if you're in-house counsel or you're a business owner and you're thinking about insider trading, it goes beyond just things that affect your stock price," Shanks said. "It could be really any confidential information involved with your company like product launch dates, or internal company milestones, environmental incidents, a marketing campaign that hasn't launched yet. And so, the world view, the scope of it is just so much broader."

A core element of insider trading is the use of material non-public information obtained through a breach of duty and used in a trade. This used to be relatively easy for employees to recognize and define, but prediction markets have made this murky, Chase said.

"From an in-house counsel perspective, the data that could potentially constitute material non-public information becomes vastly greater, and as a result, is that much more difficult to deal with," Chase said.

One recent high-profile case of insider trading within prediction markets is that of a soldier charged with using classified information to bet on the raid to capture Nicolás Maduro in Venezuela. He obtained \$400,000 from the trade. In another case, a Google employee was charged after betting using company analytics on Polymarket (one popular prediction market platform) for contracts relating to the most popular year-end search terms.

Celia Cohen, a partner at Ballard Spahr, said it is common for regulatory issues to arise for companies as new technologies evolve. She pointed to the invention of cryptocurrency and its associated regulations as an example. But, especially with the broadening of what might be considered non-public information, companies and their in-house counselors must begin to put guardrails in place against potential misuse of these markets.

"What I think is unique about the prediction markets is at first blush you think, 'Oh, prediction markets, that's something that people are going out in their own time and doing.' But, if you step back and think about it, it's not only the straightforward MNPI — material non-public information — that someone might gather from the fact that a company is going public or something like that, but it's much broader than that," Cohen said.

This lack of clarity on what might be considered insider information goes beyond what most in-house counselors are thinking about on a day-to-day basis, she said. In an example, Cohen said to picture a caterer who is working at a big event. Ahead of the event, they learn a celebrity will be making an appearance. They bet on the probability of the celebrity showing up to the event on a prediction market. Is this considered insider trading?

Shanks said the CFTC is working to regulate these markets, but with no case law or regulations currently on the books and such a wide variety of possible event contracts businesses are in a legal gray area.

"The CFTC is actively pursuing enforcement matters over something that is currently being litigated in federal courts across the country. And so, until that settles, I think the simple (...) answer is there just isn't the rules and regulations set in stone yet, and so particularly if you're in-house counsel understand that there's a lot of risk associated with that," Shanks said. "That's why you need to be very proactive about this. Recognize that it is an issue that is here and now."

Protecting the company

In an article Cohen co-wrote alongside her colleagues published by her firm, she pointed out that there is an ongoing federal-state jurisdictional conflict as the regulations for these markets are being decided.

"While the CFTC asserts exclusive federal authority, several states are taking the position that prediction market event contracts are indistinguishable from sports betting and should be regulated under state gambling laws," she wrote. "As a result, as of now, more than 20 lawsuits and cease-and-desist actions against prediction market platforms are pending across the country, a 38-state coalition has filed briefs in pending actions in support of Maryland's and Massachusetts's position that state gambling oversight authority is not preempted by federal law, and a bipartisan group of 41 state attorneys general has recently filed comments with the CFTC asserting that prediction market contracts are indistinguishable from sports betting and should be regulated under state gambling laws."

As of this spring, the Third Circuit decided the markets are subject to federal, not state, regulation. But the Ninth Circuit recently held oral arguments in a similar case where the judges seemed skeptical of this, according to the article.

Cohen said in-house counselors need to pay close attention to this debate.

"It looks like the case law so far is showing that (...) these would be federally regulated swaps and subject to CFTC, but I think it does remain to be seen, given that there is this ongoing argument about it," Cohen said. "So, I think that companies need to be watching it. I think companies need to be really thinking about both jurisdictions for now, and to make sure that they're compliant both with state laws and with the CFTC."

Even as the regulatory landscape is evolving, in-house counselors need to be proactive in their approach to prediction markets and that starts with creating a working definition of what is considered material non-public information.

"I think expanding the parameters of what constitutes material non-public information and establishing, to some extent, bright red lines, clear rules that, for example, may prohibit employees from trading any betting contract that references the company or discusses the company or its subsidiaries or its close competitors or its industry peers, is a possible way to go," Chase said. "

Additionally, in-house counselors should make themselves or another resource available for employees to ask questions about prediction markets, should update their employee handbooks and should consider training or educating employees on what could potentially be considered insider trading on these platforms, Chase said.

"Corporate counsel also has to make clear that you can still be liable or be criminally guilty of insider trading, even if you don't trade. Even if you just tip somebody for some form of personal benefit," Chase said. "I think that sometimes is a blind spot. People don't always understand that even though they themselves did not trade, they still can get in trouble for providing the information if it's in breach of a duty, and the information is material and not public."

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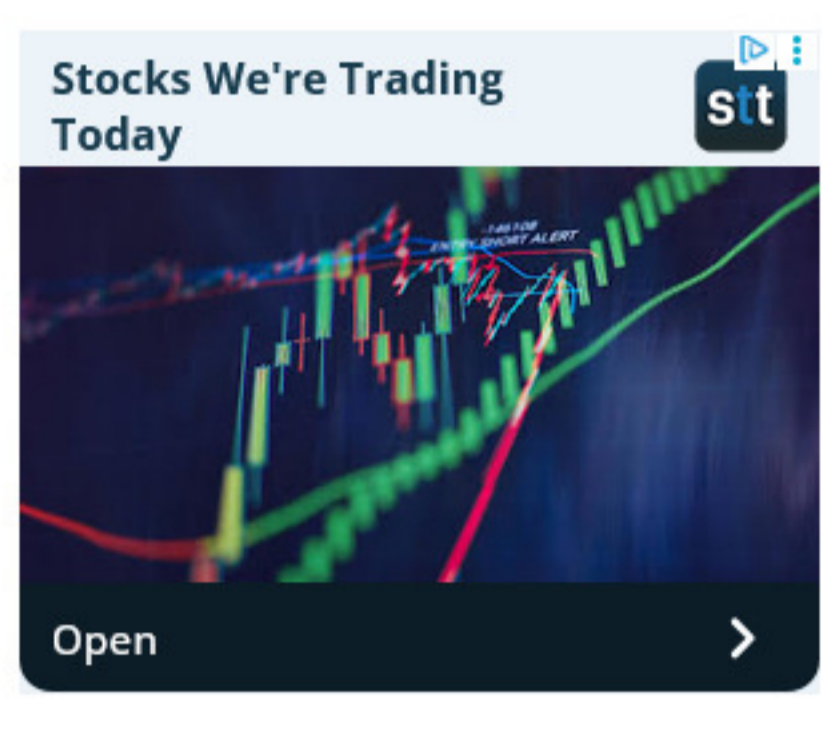
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